Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Misuse of Internet Protocol (IP) Captioned Telephone Service	)	CG Docket No. 13-24
	)	
	)	
Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities	)	CG Docket No. 03-123
	)	

PETITION FOR RECONSIDERATION

Pursuant to Section 1.429 of the Commission's rules,[1] Hamilton Relay, Inc. ("Hamilton") seeks reconsideration of one aspect of the *Report and Order, Further Notice of Proposed Rulemaking, and Order* in the above-referenced docket (the "*Order*").[2] Specifically, the Commission should reconsider and rescind its conclusion that IP CTS providers may only treat costs associated with implementing the Telecommunications Relay Service User Registration Database ("Database") during the interim IP CTS compensation period as recoverable exogenous costs if such costs "(1) belong to recoverable cost categories, (2) are new costs not factored into the rates for the 2018-19 and 2019-20 TRS Fund years, and (3) if unrecovered may cause a provider's current allowable-expenses-plus-operating margin to exceed its IP CTS revenues."[3] The requirement that costs must belong to recoverable cost categories is not rational (because the

[1] 47 C.F.R. § 1.429. This petition for reconsideration is procedurally proper under Section 1.429(b)(2), because even though Hamilton had an opportunity to comment on a draft version of the *Order* prior to its adoption, the provisions of the *Order* at issue here were substantially altered from the draft *Order*, and thus unknown to Hamilton until after its last opportunity to present arguments against them to the Commission.

[2] *Misuse of Internet Protocol (IP) Captioned Telephone Service et al.*, Report and Order, Further Notice of Proposed Rulemaking, and Order, CG Docket Nos. 13-24, 03-123, FCC 19-11 (rel. Feb. 15, 2019) ("*Order*").

[3] *Id.* ¶ 26.

Commission has not yet formally established such categories for IP CTS) and circular (because the *Order* itself finds that Database-related costs are recoverable). The proviso that Database costs are only recoverable if they otherwise might cause a provider's current allowable-expenses-plus-operating margin to exceed its IP CTS revenues is inconsistent with the Commission's own stated objectives for IP CTS rates, as well as its long history of rate regulation. As such, it violates the Commission's requirement that TRS rates appropriately compensate providers. Finally, the harms imposed by the *Order*'s limitation on cost recovery are compounded by flaws in the interim IP CTS rate, which provide incentives for providers to forego quality in exchange for cost savings. For these reasons, the Commission should allow recovery of Database costs without applying the three-pronged limitation outlined in the *Order*, and move quickly to adopt a permanent IP CTS rate that appropriately compensates providers for all reasonable costs and allows a reasonable operating margin.

I. THE "RECOVERABLE COST CATEGORIES" REQUIREMENT IS IRRATIONAL BECAUSE THE COMMISSION HAS NOT FORMALLY IDENTIFIED RECOVERABLE COST CATEGORIES FOR IP CTS AND HAS FOUND THAT DATABASE COSTS SHOULD BE RECOVERABLE

The *Order* provides that, in order for Database-related costs to be recoverable, they must "belong to recoverable cost categories."[4] This requirement, imported from the VRS context, is irrational in the context of capped interim IP CTS rates, particularly at a time when the Commission has a pending *Further Notice of Proposed Rulemaking* specifically examining what cost categories should apply to IP CTS.[5]

As the *Order* notes, the limitations placed on exogenous recovery of IP CTS Database

[4] *Order* ¶ 26.

[5] *Misuse of Internet Protocol (IP) Captioned Telephone Service et al.*, Report and Order, Declaratory Ruling, Further Notice of Proposed Rulemaking, and Notice of Inquiry, 33 FCC Rcd 5800, 5837-42 ¶¶ 71-84 (2018) ("*2018 Interim Rate Order*" or "*2018 IP CTS FNPRM*", as appropriate).

costs were first imposed in the VRS compensation context.[6] In 2017, the Commission agreed with VRS providers that certain categories of costs should be recoverable as exogenous costs, but only if four conditions were met. Among other things, the Commission required that a cost "belong to a category of costs that the Commission has deemed allowable."[7] In the VRS context, this might have made sense, because (1) the Commission has established allowable costs for purposes of compensation; and (2) the class of potential exogenous costs at issue was broad, such that some might be allowed while others were disallowed. Neither of these claims applies, however, in the IP CTS context. First, the Commission has never established what costs are allowed or disallowed for IP CTS ratemaking purposes. Rates were until recently set via the Multistate Average Rates Structure ("MARS") plan, and are now governed by the interim rate cap. Neither of these approaches relies on the distinction between allowable and non-allowable costs. Moreover, the Commission cannot now rely on informal cost categories used by the TRS Fund Administrator in prior fund years, because that cost information was collected according to cost-category exclusions that were not subject to formal notice-and-comment scrutiny and were not formally approved by the Commission.[8] Indeed, the Commission has an ongoing rulemaking proceeding which specifically requests comment on what cost categories should apply to IP CTS.[9] The Commission cannot rely on informal cost categories for IP CTS that were never approved by the Commission, and it cannot prematurely rely on proposed ones.

Second, whereas the question of whether a cost was allowed might be relevant for VRS, where the Commission was opening the door to a variety of potential exogenous costs, that is not

[6] *See Order* ¶ 26; s*ee also Structure and Practices of the Video Relay Service Program*, Report and Order and Order, 32 FCC Rcd 5891, 5925 ¶ 66 (2017) ("*2017 VRS Order*").

[7] *Id.*

[8] *See* Hamilton Ex Parte Letter, CG Docket Nos. 13-24, 03-123, at 2 (filed Nov. 14, 2017).

[9] *2018 IP CTS FNPRM*, 33 FCC Rcd at 5837-42 ¶¶ 72-84.

the case here. The only costs at issue are those associated with the Database, and the *Order* concludes that such costs "were not considered when the interim IP CTS compensation rates were determined."[10] Put differently, the *Order* itself concludes that exogenous-cost recovery of Database costs is appropriate; the Commission should not cabin this conclusion by imposing a circular requirement that such costs are only appropriately recovered when their recovery is appropriate.

In short, because the Commission has not established allowable and disallowed categories of costs for IP CTS, and because the *Order* itself indicates that Database costs should be recoverable, the Commission should rescind any separate requirement that such costs must have been deemed allowable in order for an IP CTS provider to seek recovery.

II. THE REQUIREMENT THAT A PROVIDER BE FISCALLY "UNDER WATER" IN ORDER TO RECOVER DATABASE-RELATED COSTS IS PROCEDURALLY IMPROPER AND INCONSISTENT WITH THE COMMISSION'S STATED GOALS

The Commission also should reconsider and rescind its determination that a provider must demonstrate that Database implementation costs, "if unrecovered[,] may cause a provider's current allowable-expense-plus-operating margin to exceed its IP CTS revenues."[11] This "no recovery unless under water" approach is procedurally improper because it relies on categories of allowable expenses that were not subject to proper notice-and-comment and are the subject of a pending proceeding.[12]

The limitation on cost recovery is also contrary to the Commission's stated goals for the service. When the Commission adopted its interim IP CTS rate in 2018, it underscored that its

[10] *Order* ¶ 26.

[11] *Id.*

[12] *See supra* notes 8-9.

"mandate in determining TRS rates is to ensure that the rates 'correlate to actual reasonable costs.'"[13] It then determined that the "zone of reasonableness" for return on IP CTS providers' recovery was the same as for VRS providers – namely, an operating margin "between 7.6% [and] 12.35%."[14] It further recognized that, even assuming this operating margin, immediate reduction of the IP CTS rate to this level "could produce a disruption in the IP CTS market and potentially negative consequences for both providers and consumers," and that "a significant and sudden cut to providers' compensation" would be harmful to all involved.[15]

Although Hamilton disagrees with the ways in which the Commission effectuated these principles,[16] it agrees with the Commission that sudden disruptions to a provider's ability to recoup its costs will have deleterious consequences for IP CTS services and consumers. Unfortunately, the *Order*'s holding that Database costs are only recoverable if they otherwise might "cause a provider's current allowable-expense-plus-operating margin to exceed its IP CTS revenues" violates these principles.

First, the *Order*'s approach ignores the core precept that a provider must be able to recover its reasonable costs, including costs imposed by government mandates. This principle has been at the heart of the Commission's approach to rate regulation for decades. In 1988, when the agency first detailed the price cap regime it was contemplating for certain local exchange carriers ("LECs"), it tentatively found that "price cap levels must be permitted to rise

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[13] *2018 Interim Rate Order*, 33 FCC Rcd at 5808-09 ¶ 16(quoting *Misuse of Internet Protocol (IP) Captioned Telephone Service; Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, 28 FCC Rcd 13420, 13477-78 ¶¶ 120-24 (2013)).

[14] *2018 Interim Rate Order*, 33 FCC Rcd at 5813 ¶ 23.

[15] *Id.* (internal quotation and citations omitted).

[16] *See, e.g.*, Comments of Hamilton Relay, Inc., CG Docket Nos. 13-24, 03-123 (filed Sept. 7, 2018) ("*Hamilton Comments Supporting Sprint Petitions for Reconsideration*").

and fall according to an index of the cost of factors of production (*i.e.*, inflation), anticipated changes in carrier productivity, *and changes in costs due to changes in laws, regulations, or other factors that are beyond a carrier's control*" – *i.e.*, exogenous costs.[17] Thus, "changes in certain exogenous costs … must trigger adjustments to price caps."[18]

In 1989, the Commission reiterated this point in the same docket, explaining that "in our price cap plan, changes in certain exogenous costs … are flowed through directly to prices," such that one dollar of increased costs resulted in one dollar of additional permitted recovery under the price cap.[19] And in 1990, when it adopted the price-cap regime for LECs, it confirmed that exogenous costs "are costs that should result in an adjustment to the cap in order to ensure that the price cap formula does not lead to unreasonably high or unreasonably low rates."[20] As the Commission emphasized there, exogenous costs arise from changes that "are imposed by regulators and are outside the control of carriers."[21] Such decisions, which are designed to advance public policy objectives, "must affect the cap in order to ensure that the system results in rates that are just and reasonable."[22] Moreover, the Commission recognized that rates that are too *low* are as problematic as rates that are too high: Rates that prohibit reasonable returns on a provider's investment can lead to "[u]nusually low earnings," which "over a prolonged period could threaten the [provider's] ability to raise the capital necessary to provide modern, efficient

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[17] *Policy and Rules Concerning Rates for Dominant Carriers*, Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195, 3383-84 ¶ 336 (1988) (emphasis added).

[18] *Id.*

[19] *Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, 2995 ¶ 233 (1989).

[20] *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, 6807 ¶ 166 (1990).

[21] *Id.* at 6807 ¶ 167.

[22] *Id.*

services to customers."[23]

In short, the Commission has long recognized that regulated rates only work when they allow the rate-regulated provider to recoup its costs and a reasonable operating margin, and that when costs rise (or fall) as a result of government action (or other exogenous factors), the rate caps must rise (or fall) as well, to maintain the appropriate permissible margin. By refusing to permit recovery unless the costs otherwise would lead to operating losses, the *Order* repudiates this well-established Commission precedent, without rationally explaining that departure. The exclusion of certain IP CTS providers from Database cost recovery, based on their supposed ability to "afford it," conflicts with the agency's "obligation to ensure that rates fall within the zone of reasonableness."[24] Even assuming for the sake of argument that the interim rate appropriately compensates IP CTS providers (a proposition Hamilton disputes), that interim rate did not account for the additional Database-related costs arising from the *Order*. The *Order* acknowledges as much.[25] By definition, imposition of these new costs will force margins for IP CTS below the range deemed acceptable by the *2018 Interim Rate Order*. This would likely require providers to cut costs, potentially harming service quality, or to halt investment in their IP CTS services. These results would be harmful for consumers and providers alike, and would disserve Americans who rely on IP CTS to achieve functionally equivalent telephone communication.

Second, the *Order*'s approach disregards the Commission's 2018 determination that a sudden reduction in a provider's operating margin "could produce a disruption in the IP CTS

[23] *Id.* at 6804 ¶ 147.

[24] *Policy and Rules Concerning Rates for Dominant Carriers*, 3 FCC Rcd at 3383-84 ¶ 336.

[25] *Order* ¶ 26 ("Database implementation costs … were not considered when the interim IP CTS compensation rates were determined.")

market and potentially negative consequences for both providers and consumers."[26] There is, of course, no practical difference between "a significant and sudden cut to providers' compensation"[27] and a significant and sudden *increase* in providers' *costs*. As Hamilton and others have made clear, Database-related costs are likely to be substantial.[28] By forcing IP CTS providers to bear those costs without recovery unless and until the costs wipe out the provider's return on investment, the Commission has guaranteed precisely the sort of precipitous decline in provider margins that it claimed to be avoiding by adopting a glide-path toward new IP CTS rates.

In light of the above, the *Order*'s Database cost recovery framework is flatly unlawful. Section 64.604(c)(5)(iii)(E) of the Commission's rules states that rates for TRS, including IP CTS, "shall be designed to compensate TRS providers for reasonable costs of providing interstate TRS," and "should appropriately compensate interstate providers for the provision of TRS, whether intrastate or interstate."[29] As detailed herein, however, the *Order*'s approach to recovery of Database costs ensures that rates will not "appropriately compensate" providers for their provision of IP CTS. Instead, the new framework begins with rates that the Commission agrees did not account for Database-related costs, then requires providers to bear those costs except where doing so will reduce their operating margins to zero. Just last year, however, the Commission determined that the "appropriate" margin for IP CTS was between 7.6% and

[26] *2018 Interim Rate Order*, 33 FCC Rcd at 5814 ¶ 24.

[27] *Id*.

[28] *See, e.g.*, Letter from David A. O'Connor, Counsel for Hamilton Relay, Inc., to Marlene H. Dortch, Secretary, Federal Communications Commission, CG Docket Nos. 13-24, 03-123 (filed Feb. 7, 2019); Letter from Tamar E. Finn, Counsel to ClearCaptions, LLC, to Marlene H. Dortch, Secretary, FCC, CG Docket Nos. 13-24, *et al.* at 2 (filed Feb. 8, 2019); Letter from David A. O'Connor, Counsel for Hamilton Relay, Inc., to Marlene H. Dortch, Secretary, Federal Communications Commission, CG Docket Nos. 13-24, 03-123, at 2-3 (filed Apr. 1, 2019).

[29] 47 C.F.R. § 64.604(c)(5)(iii)(E).

12.35%. By definition and by design, then, the *Order* deprives IP CTS providers of compensation deemed appropriate, refusing to allow recovery and a reasonable return on reasonably incurred costs – all contrary to the Commission's rules.

Thus, the *Order* effectuates a regime that is both unlawful and inimical to the interests of the IP CTS program. In addition to being contrary to the Commission's rules, it would help ensure under-recovery, which in turn is likely to have negative consequences for providers and consumers alike. Indeed, the *Order*'s approach would all but guarantee a sudden drop-off in providers' operating margins for IP CTS – a result the Commission explicitly sought to avoid in adopting the interim rate regime less than a year ago. For these reasons, the Commission should reconsider and eliminate its restrictions on Database implementation costs.

III. GIVEN THE INTERIM RATE REGIME'S OTHER DEFECTS, THE *ORDER*'S FRAMEWORK VIOLATES THE COMMISSION'S RULES REGARDING TRS RATESETTING

As detailed above, the *Order*'s refusal to allow recovery of Database costs except under certain limited conditions would be impermissible even if the rates for IP CTS were otherwise just and reasonable. However, they are not. Rather, as Hamilton and others have made clear, the Commission's 2018 rate decision led to an interim regime featuring rates that do not compensate providers for their reasonable costs. As Hamilton has stated, IP CTS rate cuts could create incentives for providers to sacrifice superior service quality while reducing a provider's means of maintaining quality standards.[30] The *Order* compounds this problem by imposing new exogenous costs and then effectively refusing to allow providers to recover these costs unless failure to recover would put them "in the red." Thus, the *Order* removes capital from providers who are already facing a significant decline in resources as a result of recent rate cuts.

[30] *See Hamilton Comments Supporting Sprint Petitions for Reconsideration* at 5.

Accordingly, the *Order*'s effect of on providers' ability to offer high-quality IP CTS services is likely to be even more significant today than it might have been even one year ago.

IV. CONCLUSION

For the reasons stated above, the Commission should reconsider and eliminate the restrictions it has placed on exogenous recovery of Database-related IP CTS costs. It should reaffirm that Section 64.604(c)(5)(iii)(E) of its rules requires reasonable compensation for providers, particularly as here where the costs are mandatory and imposed by regulatory fiat.

Respectfully submitted,

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